



# POLICY BRIEF



## THE DANGER OF MANDATING ESG DISCLOSURES

On May 20, 2021, President Biden signed an Executive Order titled “Climate-Related Financial Risk,” that creates a framework for a whole-of-government approach to incorporate environmental “risks” into financial regulation and supervision.<sup>1</sup> On the 2020 Presidential campaign trail, President Biden supported requiring public companies to disclose details related to not just environmental, but also social and governance (ESG) “risks” to their operations and supply chains.<sup>2</sup> These ESG “risks” include a broad range of nonfinancial factors, such as carbon emissions and diversity quotas, that some believe companies should address when disclosing a company’s financial performance to investors and regulators.

**Table 1: Examples of Environmental, Social, and Governance Factors**

Environmental	Social	Governance
Climate change impacts and greenhouse gas emissions	Labor standards	Board composition
Energy efficiency	Human rights	Executive compensation
Renewable energy	Employee engagement	Audit committee structure
Air, water, resource depletion, or pollution	Customer satisfaction	Bribery and corruption
Waste management	Community relations	Whistleblower programs
Biodiversity impacts	Gender and diversity	Accident and safety management

Source: GAO analysis of documentation from the CFA Institute, Sustainable Accounting Standards Board, and Principles for Responsible Investment. | GAO-20-530

Prior to the signing of the Executive Order, the Securities and Exchange Commission (SEC) had already made this initiative a top priority by creating a Climate and ESG Task Force, inviting public comment on climate change disclosures, and launching a new page on its website focused on the latest information on ESG investing, among other steps.<sup>3</sup> When SEC Commissioner Hester Peirce compared ESG assessments developed by private boards to *The Scarlet Letter*, she noted that they are being used as a weapon to publicly shame certain businesses.<sup>4</sup> This shaming often targets businesses not politically favored by Democrats and has led to billion dollar lawsuits, lack of access to capital, and the booting of board directors.<sup>5</sup> This all has the effect of fewer companies choosing to go public, leading to fewer investment opportunities for everyday Americans.

- **Democrats want to reshape the mission of the SEC to impose their political agendas.**
  - The SEC’s mission is to protect investors; maintain fair, orderly, and efficient markets; and facilitate capital formation. Democrats are reshaping the SEC’s mission by exploiting securities laws to advance their liberal social agenda by imposing burdensome regulations.<sup>6</sup>
  - While Commissioner Allison Herren Lee has argued disclosures on climate risks should be mandated by the SEC, issues related to environmental quality are under the jurisdiction of the Environmental Protection Agency (EPA) and beyond the SEC’s statutory authority. Federal securities laws are relatively narrow in scope, and Commissioner Elad Roisman has admitted that, “if I were to use the securities laws to pursue my own environmental and social vision for the world, I would be subordinating the SEC’s mission to my personally held objectives.”<sup>7</sup>

- **Establishing universal ESG metrics would be complex and invite bias.**

- In recent years, most companies have voluntarily chosen to provide information to their shareholders on non-financial, ESG topics, without being required to do so by government mandate. For example, 90% of S&P 500 companies voluntarily published sustainability reports in 2019.<sup>8</sup>
- As SEC Commissioners and other experts have noted, matters that fall under the category of an ESG risk are often subjective and evolving.<sup>9</sup> This is reflected in the seven different ESG standard-setting organizations that create voluntary reporting frameworks, each containing different disclosure topics.<sup>10</sup>
- Depending on the approach chosen, the metric could favor certain companies over others based on subjective, moral judgements rather than financially material information that is currently required. For example, Tesla could be one of the highest or lowest ESG-rated automakers, depending on if the standard focuses on its environmental rating or its workers' rights rating.<sup>11</sup>
- Certain disclosure requirements may be deemed relevant for some companies and not others depending on the nature of the business, but mandated disclosures creating a one-size-fits-all approach would create enormous and inequitable compliance burdens for companies.

- **Wall Street is fueling and profiting off the ESG movement.**

- While investors are exhibiting increased demand for ESG funds, the movement is increasingly being fueled by Wall Street, where fund managers and consultants are looking to line their own pockets whether it is in the best interests of investors or not.
- The profit is driven by larger fees charged by fund managers for ESG funds compared to the other broader funds. For example, exchange-traded funds (ETFs) solely focused on ESG investments have 43% higher fees than passive index ETFs, although they are not more expensive to run.<sup>12</sup> The fee difference could amount to over \$1 million for a firm managing a \$2 billion ESG fund.
- The interests of Wall Street are also reflected in the increased lobbying efforts in favor of ESG issues by investment managers, such as BlackRock, which put \$68 billion into ESG products last year.<sup>13</sup>
- Fueled by pecuniary interests, unions, public pension funds, and activist investors are coordinating to change companies' behavior toward political issues and reshape capitalism in America as we know it.

Congress must conduct oversight of the Administration and SEC's actions to ensure Democrats in Washington are not pushing their social agenda through an inappropriate vehicle such as securities laws. Instead of broad government mandates, companies should have the freedom to utilize voluntary metrics best-suited for their specific business and the interests of their shareholders.

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<sup>1</sup> Executive Order 14030: Climate-Related Financial Risk. Federal Register. May 25, 2021.

<https://www.federalregister.gov/documents/2021/05/25/2021-11168/climate-related-financial-risk>

<sup>2</sup> The Biden Plan for Clean Energy Revolution and Environmental Justice. <https://joebiden.com/climate-plan/>

<sup>3</sup> SEC Announces Enforcement Task Force Focused on Climate and ESG Issues. U.S. Securities and Exchange Commission. March 4, 2021. <https://www.sec.gov/news/press-release/2021-42> and Commissioner Allison Herren Lee. Public Input Welcomed on Climate Change Disclosures. U.S. Securities and Exchange Commission. March 15, 2021. <https://www.sec.gov/news/public-statement/lee-climate-change-disclosures> and SEC Responds to Investor Demand by Bringing Together Agency Information About Climate Change and ESG Issues. U.S. Securities and Exchange Commission. March 22, 2021. [https://www.sec.gov/news/press-release/2021-52?utm\\_medium=email&utm\\_source=govdelivery](https://www.sec.gov/news/press-release/2021-52?utm_medium=email&utm_source=govdelivery)

<sup>4</sup> Commissioner Hester M. Peirce. Scarlett Letters: Remarks before the American Enterprise Institute. U.S. Securities and Exchange Commission. June 18, 2019. <https://www.sec.gov/news/speech/speech-peirce-061819>

<sup>5</sup> Laurel Wamsley. Exxon Is On Trial, Accused Of Misleading Investors About Risks Of Climate Change. NPR. October 22, 2019. <https://www.npr.org/2019/10/22/772241282/exxon-is-on-trial-accused-of-misleading-investors-about-risks-of-climate-change> and Swetha Gopinath. Poor ESG Profile Could Shut Off Access to Capital, Amundi Says. Bloomberg. October 28, 2020. <https://www.bloomberg.com/news/articles/2020-10-28/poor-esg-profile-could-shut-off-access-to-capital-amundi-says> and Attracta Mooney. BlackRock punishes 53 companies over climate inaction. Financial Times. July 14, 2020. <https://www.ft.com/content/8809032d-47a1-47c3-ae88-ef3c182134c0>

<sup>6</sup> About the SEC. U.S. Securities and Exchange Commission. <https://www.sec.gov/about.shtml>

<sup>7</sup> Allison Herren Lee. Big Business's Undisclosed Climate Crisis Plans. The New York Times. September 27, 2020. <https://www.nytimes.com/2020/09/27/opinion/climate-change-us-companies.html> and Commissioner Elad L. Roisman. Keynote Speech at

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the Society for Corporate Governance National Conference. U.S. Securities and Exchange Commission. July 7, 2020.

<https://www.sec.gov/news/speech/roisman-keynote-society-corporate-governance-national-conference-2020>

<sup>8</sup> 90% of S&P 500 Index Companies Publish Sustainability Reports in 2019, G&A Announces in its Latest Annual 2020 Flash Report. Global Newswire. Jul 16, 2020. <https://www.globenewswire.com/news-release/2020/07/16/2063434/0/en/90-of-S-P-500-Index-Companies-Publish-Sustainability-Reports-in-2019-G-A-Announces-in-its-Latest-Annual-2020-Flash-Report.html>

<sup>9</sup> Commissioner Elad L. Roisman. Keynote Speech at the Society for Corporate Governance National Conference. U.S. Securities and Exchange Commission. July 7, 2020. <https://www.sec.gov/news/speech/roisman-keynote-society-corporate-governance-national-conference-2020>

<sup>10</sup> Public Companies: Disclosure of Environmental, Social, and Governance Factors and Options to Enhance Them. U.S. Government Accountability Office. July 2020. <https://www.gao.gov/assets/gao-20-530.pdf>

<sup>11</sup> Chris Flood. SEC chair warns of risks tied to ESG ratings. The Financial Times. May 27, 2020. <https://www.ft.com/content/2c662135-4fd3-4c1b-9597-2c6f8f17faed>

<sup>12</sup> Michael Wursthorn. Tidal Wave of ESG Funds Brings Profit to Wall Street. The Wall Street Journal. March 16, 2021.

<https://www.wsj.com/articles/tidal-wave-of-esg-funds-brings-profit-to-wall-street-11615887004>

<sup>13</sup> Andrew Ramonas. Democrats' ESG Drive Fuels Lobbying Bonanza in Washington. Bloomberg Law. May 3, 2021.

<https://news.bloomberglaw.com/esg/democrats-esg-drive-fuels-lobbying-bonanza-in-washington> and Michael Wursthorn. Tidal Wave of ESG Funds Brings Profit to Wall Street. The Wall Street Journal. March 16, 2021. <https://www.wsj.com/articles/tidal-wave-of-esg-funds-brings-profit-to-wall-street-11615887004>